IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO DIVISION OF FINANCIAL MANAGEMENT OCTOBER 2005 VOLUME XXVIII NO. 4

Will Hurricanes Katrina and Rita be the disasters that usher in American consumers' winter of discontent? There is no doubt these storms have shaken consumers' collective sense of well-being. The increased anxiety has manifested itself in declining consumer confidence. The University of Michigan Index of Consumer Sentiment dropped to 76.9 in September 2005, which is even lower than after the September 11, 2001 attacks. This decline comes on the heels of a dearth of personal savings and high-debt loads. Will the confidence decline be the third strike that finally transforms U.S. consumers from spendthrifts to penny pinchers? This is an important question because a retreat in consumer spending raises the odds of the nation slipping into a recession.

September's consumer confidence decline followed August's 1.0% decline in real consumer spending. The spending setback was due to a huge decline in durable goods sales, primarily a decline in auto sales. Annualized vehicle sales dropped from 20.7 million units in July to 16.7 million units in August, then fell to 16.3 million units in September. On a raw volume basis, 1.32 million cars and light trucks were sold during September 2005, which was 8.0% lower than in the previous September. Light-truck sales have been particularly hard hit, with its share total sales shrinking from a high of 61% in July 2005 to 51% just two months later.

While it is tempting to blame the hurricanes for the recent drop in real consumer spending, the storms had little to do with the decline. In fact, the spending swing was expected long before the hurricane season started.

Thanks to the success of "employee discount pricing" programs by major vehicle manufacturers, estimated annual light vehicle sales hit nearly 18 million units in the third quarter of 2005, which boosted annualized spending on motor vehicles and parts 28.8% in that quarter. The strong sales this summer reflects the acceleration of vehicle purchases that would have otherwise taken place in the fall. As a result, sales were expected to retreat this fall after the incentive programs ended. For example, Global Insight projected annualized car and light vehicle sales would drop to 16.2 million units in the fourth quarter. September's vehicle sales show the forecast is nearly spot on so far. The retreat in vehicle sales is a major contributor to the expected slowdown in real consumer spending at the end of this year.

Clearly, the hurricanes did not cause the spending slide. However, the storms did accentuate the drop. This can be seen by comparing Global Insight's August 2005 U.S. economic forecast to its October 2005 forecast. Real consumer spending in the August 2005 forecast was expected to grow about 4% in the third quarter of 2005 followed by 1.7% in the fourth quarter. In the October 2005 forecast, real consumer spending advances 3.3% in the third quarter and 0.2% in the fourth quarter. Interestingly, this slowdown is short lived; by the second quarter of 2006, real consumer spending should grow faster than had been forecast in August 2005.

The storm's biggest economic impacts will be on energy prices. Consumers saw gasoline prices climb above $3 per gallon soon after Hurricane Katrina hit land, and Hurricane Rita threatened to take the price over $4 per gallon. Fortunately, Hurricane Rita did less damage than her big sister. The next price shock will come this winter when consumers pay up to 50% more than last year for natural gas. The average household energy bill (including gasoline, fuel oil, natural gas, and electricity) will reach an annual rate of $4,900 in the fourth quarter of 2005, which is 22% above its year-ago level. This increase will act like a tax on consumers, and lower their disposable income. This will reduce the amount consumers have left for discretionary spending. The holidays will be a critical time, as consumers open their high heating bills just as they put together their Christmas shopping lists. But even these impacts, though painful, should be temporary. Energy prices are expected to gradually retreat over the next three years as inventories are rebuilt.

It should be pointed out that in several ways the hurricanes' impacts were less than feared. Thankfully, the loss of life appears to have been much lower than early estimates. The post-Katrina job loss was much lower than had been predicted. This suggests the economy had more momentum in the third quarter, and this should help it weather the hurricanes' impacts better than had been anticipated. Real consumer spending will be challenged during the second half of this year. However, predictions of its death are greatly exaggerated. Thanks to the boost from rebuilding efforts, real consumer spending is expected to pick up speed in 2006 and continue growing for the foreseeable future. Bolstered by the consumer spending rebound, the U.S. economy should also continue expanding.

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General Fund Update

As of September 30, 2005

Revenue Source	FY06 Executive Estimate[3] ($ Millions)	DFM Predicted to Date ($ Millions)	Actual Accrued to Date ($ Millions)
Individual Income tax	1,089.9	227.5	230.1
Corporate Income tax	155.8	35.3	40.6
Sales Tax	827.8	234.1	248.1
Product Taxes[1]	23.1	6.2	6.3
Miscellaneous	107.1	26.7	26.2
TOTAL GENERAL FUND[2]	**2,203.7**	**529.8**	**551.3**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of August 2005

General Fund revenue registered its third consecutive month of strength in September, coming in $11.5 million higher than expected. This brings the fiscal year-to-date excess to $21.6 million. The corporate income tax and the sales tax are behind the month's strength, and are also the primary source of the year-to-date excess.

Individual income tax revenue was $1.1 million higher than expected in September, continuing a trend of modest gains over the predicted amount. This category is now $2.6 million ahead of expectations on a year-to-date basis. One mildly alarming aspect of the September results is buried in the detail. After being slightly ahead of expectations in July and August, withholding collections came in $6.2 million below expectations in September. Fortunately, this was more than offset by filing payments that were $7.6 million higher than expected. Combined refunds and miscellaneous diversions were $1.3 million higher than expected.

Corporate income tax revenue was $5.7 million higher than expected in September, and is now $5.4 million higher than expected on a year-to-date basis. Filing payments were $1.0 million lower than predicted for the month, but quarterly estimated payments were $5.2 million higher than predicted. Refund payments were $0.7 million lower than expected for the month, while miscellaneous diversions were $0.8 million lower than expected in September.

Sales tax revenue was $4.1 million higher than expected in September, making this the third straight month of stunning sales tax collections this fiscal year. The year-over-year gross collection growth figures tell it all – the current forecast is 7.4% growth for the full year, yet actual year-over-year growth in July through September has been 8.9%, 12.9%, and 15.4%, respectively. The year-to-date sales tax excess of $14.0 million accounts for just under two-thirds of the entire General Fund revenue excess as of the end of September.

Product taxes were slightly ahead of target in September on strong cigarette and tobacco tax collections, while miscellaneous revenue was $0.5 million higher than expected for the month on strong insurance premium tax and estate tax collections.